IN THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF FLORIDA

In re TELECARD COMMUNICATIONS INTERNATIONAL, INC., Debtor.

No. 99-24811-BKC-RBR.
(Cite as: 2001 WL 1750774)

ORDER OVERRULING TRUSTEE'S OBJECTION AND AMENDED OBJECTION TO CLAIMS

The Debtor, Telecard Communications International, Inc. ("Telecard") filed for protection under Chapter 11 of the Bankruptcy Code on July 20, 1999, and Marika Tolz was subsequently appointed Chapter 11 Trustee. The bankruptcy case was converted to one under Chapter 7 on September 28, 1999, and Marika Tolz was subsequently appointed as Chapter 7 Trustee.

The Internal Revenue Service, on behalf of the United States, filed a proof of claim, claim No. 19, in the amount of $172,563.86. The IRS filed an amended claim, No. 25, in the total amount of $182,688.86. That proof of claim consists of (1) a secured claim in the amount of $111,813.86 for unpaid FICA taxes for the quarters ending September 1997, December 1997, March 1998, and June 1998; (2) an unsecured priority claim in the amount of $70,875.00 for unpaid FICA taxes for the quarters ending September 1998, December 1998, March 1999, June 1999 and the period July 1, 1999 to the petition date, as well as unpaid FUTA taxes for the years ended 1997, 1998, 1999 and the period from July 1, 1999 to the petition date, and (3) an administrative claim for unpaid FICA and FUTA taxes for the post-petition, pre-conversion period. Government's Exh. 1 (Amended Proof of Claim).

The trustee filed a Supplemental Objection to Claim on March 9, 2001, objecting to claims No. 19 and 25. The trustee filed an Amended Objection to Claims on July 24, 2001, objecting to Claim No. 19 on the ground that it had been superseded by Claim No. 25. The trustee further objected to the priority portion of Claim No. 25 on the ground that the claim represented unpaid payroll taxes for the one year period preceding the filing of the bankruptcy petition, and that, during that period, the employees of Telecard were paid by an entity known as Omniac. The objection asserted that any amounts due and owing constituted a claim against Omniac and not Telecard. The objection also sought subordination of the secured portions of Claim No. 25 pursuant 11 U.S.C. § 724(b) and subordination of any portion of the claim for penalties pursuant to § 726(a)(4).[1] The matter came before the Court at a hearing on August 21, 2001.\

FINDINGS OF FACT

1. Telecard was a provider of communication services, and was involved in the prepaid calling industry as well as the distribution of access to telephone lines at the wholesale level.

[1]The United States does not dispute that the trustee is entitled to subordinate its claim as provided in §§ 724(b) & 726(a)(4).

Government's Exh. 5 (Dep. of K. Kuzmenko) at pp. 3-4.

2. At the time of the filing of the petition, the officers of Telecard were David Hold, president; Kenneth Kuzmenko, chief officer of operations; and Daniel Oshatz, secretary. Government's Exh. 7 (Statement of Financial Affairs) at ¶ 19(b).

3. Omniac was a corporation set up to hold patents on compression technology software being developed by two individuals, John Silver and his partner. Government's Exh. 4 (2004 Exam) at 175-76, 178; Government's Exh. 5 (Dep. of K. Kuzmenko) at pp. 9-11.

4. Telecard invested approximately $100,000 in Omniac, and received a 51% ownership interest in Omniac. Government's Exh. 4 (2004 Exam) at pp. 176-77.

5. Telecard paid Silver and his partner approximately $1,000 - $1,200 per week to develop the technology. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 10, 13; Government's Exh. 4 (2004 Exam) at p. 179.

6. Omniac did not have any employees independent of Telecard. Government's Exh. 5 (Dep. of K. Kuzmenko) at p.13.

7. Omniac did not conduct any business. Government's Exh. 4 (2004 Exam) at p. 178.

8. Omniac never generated any revenue. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 16, Government's Exh. 4 (2004 Exam) at pp.

9. Approximately one year before filing for bankruptcy, Telecard began using a bank account that was in the name of Omniac. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 13; Government's Exh. 4 (2004 Exam) at pp. 28, 30, 174.

10. Telecard began using the Omniac bank account because the government had placed a lien upon Telecard's account. Government's Exh. 4 (2004 Exam) at p. 175.

11. Omniac did not use that account for any business purpose. Government's Exh. 4 (2004 Exam) at p. 178.

12. None of the funds in the Omniac account were generated by Omniac. Government's Exh. 5 (Dep. of K. Kuzmenko) at p.14; Government's Exh. 4 (2004 Exam) at p. 178.

13. The only funds in the Omniac account were funds generated by Telecard. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 14.

14. Telecard instructed its customers to pay amounts owed Telecard into the Omniac account. Government's Exh. 5 (Dep. of K. Kuzmenko) at pp. 14-15.

15. Debts of Telecard, including rent, phone bills, and payroll were paid from the Omniac account. Government's Exh. 5 (Dep. of K. Kuzmenko) at p.15.

16. Either David Hold or Kenneth Kuzmenko decided which debts of Telecard to pay. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 16.

17. The Board of Directors of Omniac was not consulted before Telecard paid its bills out of the Omniac account. Government's Exh. 5 (Dep. of K. Kuzmenko) at p.17.

18. Kenneth Kuzmenko was a signatory on the Omniac account. Government's Exh. 4 (2004 Exam) at p. 179; Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 15

19. Kenneth Kuzmenko was never an officer, director, or shareholder of Omniac. Government's Exh. 5 (Dep. of K. Kuzmenko) at p. 19.

20. Telecard filed Form 941 FICA returns for the periods ending September 1997, December 1997, March 1998, and June 1998, but did not file returns for periods after June 1998. Government's Exh. 2 (Certificate of Assessments and Payments).

21. Form 941 provides a box for employers to check if they are not required to file future returns. Telecard's June 1998 Form 941 return does not have that box checked. Government's Exh. 3 (Telecard's 941 return for period ending June 1998).

22. Omniac did not file any Form 941 FICA returns for the periods ending June 1998, September 1998, December 1998, March 1999, June 1999, September 1999 or December 1999. Government's Exh. 8 (Certificate of Lack of Record).

23. Omniac did not file any Form 940 FUTA or Form 1120 income tax returns for the years ended 1998 or 1999. Government's Exh. 8 (Certificate of Lack of Record).

24. Telecard included unpaid salaries in its bankruptcy schedules, including priority claims for employee services for 11 employees. Government's Exh. 6 (Schedule E).

CONCLUSIONS OF LAW

A determination of the Commissioner of Internal Revenue is presumptively correct, and the party challenging the determination has the burden of proving it wrong. Welch v. Helvering, 290 U.S. 111, 115 (1933). The burden of proof is not altered in the bankruptcy context. Raleigh v. Illinois Dept. of Revenue, 120 S.Ct. 1951 (2000).

Pursuant to 26 U.S.C. §3403, employers are responsible for withholding and paying over its employees' payroll taxes. If the employer fails to do so, it then becomes liable for those unpaid taxes. 26 U.S.C. §3401(d) defines "employer" generally as "the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person" ("common law employer"). An exception does exist where the common law employer does not control the payment of its employees' wages. Section 3401(d)(1) provides that:

> if the person for whom the individual performs or performed the services does not have control of the payment of the wages, for such

> services, the term 'employer' (except for purposes of subsection (a)) means the person having control of the payment of such wages . . . .

("statutory employer"). Therefore, if the common law employer does not control the payment of wages, then the entity with such control is responsible for the payment of the payroll taxes.

In this case, it is undisputed that Telecard was the common law employer of the employees. The trustee contends, however, that Telecard did not control the payment of its employees' wages, and is not responsible for the liabilities claimed by the United States. The trustee's contention is based upon the fact that the employees of Telecard were paid from the checking account of Omniac during the relevant time period. Thus, the trustee asserts, Omniac controlled the payment of the employee's wages.

The United States does not dispute that if the common law employer does not control the payment of wages then the employer, for purposes of withholding, is the entity which does control the payment of wages. However, it does dispute the trustee's contention that Telecard did not control the payment of its employees wages. The United States argues that Omniac was used as a shell corporation by Telecard, funneling funds of Telecard through the Omniac account. The United States contends control is not determined merely by looking at the name on the checking account, and that the relationship between Telecard and Omniac reveals that Telecard actually controlled the payment of wages.

The Trustee and her expert have referred to several cases in support of the trustee's contentions. In Southwest Restaurant Systems, Inc., 607 F.2d 1237 (9th Cir. 1979), the court found that the debtor was the statutory employer of its employees and the employees of three other corporations. The ownership of the four corporations was largely held by two individuals who were also the president and treasurer of all the corporations. The corporations had consolidated accounting, bookkeeping and financial functions, with one bookkeeper handling the functions for all four corporations. Each corporation would deposit its sales receipts into separate bank accounts, but wages for each corporation's employees were paid from one payroll bank account, which was maintained by the debtor. The debtor distributed W-2 forms and filed quarterly FICA returns, both of which bore the name of the debtor. The court found that the debtor alone controlled the payment of wages, and was therefore was the statutory employer.

In Consolidated Flooring Services v. United States, 38 Fed. Cl. 450 (Ct. Cl. 1997), it was determined that the taxpayer, CFS, was the statutory employer of a group of helpers. CFS provided customers, on a contract basis, with installation of floor covering. CFS would hire out its contracts to installers, and those installers would hire a work crew of helpers. During the relevant time period, CFS would ask the installers to provide it information regarding the wages owed to the installer's helpers. CFS would then deduct that amount from its payment to the installer, and pay the helpers directly. The Court found that CFS controlled the account from which the wages were paid, and was therefore the statutory employer.

In Winstead v. United States, 109 F.3d 989 (4th Cir. 1997), the Court found that the taxpayer, a property owner, was the statutory employer of day laborers. The taxpayer, Winstead, had tenant farmers who grew tobacco on his land pursuant to sharecropping agreements. Those sharecroppers would then hire day laborers. Because the sharecroppers were unable to pay the day laborers until after the tobacco had been sold, Winstead would pay the laborers from his personal checking account, and then deduct the amount of the wages paid from the sharecropper's profits. The Winstead court found that Winstead was the statutory employer because he paid the laborers from his personal account, and the sharecroppers had no authority over that account.

In Kittlaus v. United States, 41 F.3d 327 (7th Cir. 1994), it was found that the taxpayer, an individual who owned a motel, was not the statutory employer of the motel's employees. The taxpayer, Kittlaus, was a general partner in Inn Investors, a limited partnership which owned the Stillwater Ramada. Inn. Investors contracted with a motel management agency to manage the motel. Pursuant to a management agreement, the partnership had no involvement in the day-to-day operations of the motel, had very limited access to payroll funds, and had no signature authority over the accounts used to pay the employees. The Kittlaus court concluded that the management agency, not the partnership, controlled the payment of wages.

None of the cases relied upon by the trustee addresses the situation presented in this case - a business funneling its revenues through an account bearing the name of another entity, with no evidence that the latter had any actual control over the account. While the wages of Telecard's employees were paid from an account bearing the name of Omniac, the evidence is clear that Telecard controlled that account. All of the funds contained in the account belonged to Telecard, and the officers of Telecard made the decisions regarding expenditure of those funds. Telecard did not consult with any directors of Omniac prior to writing checks on the Omniac account. Telecard was apparently using the Omniac name to avoid the collection efforts of the Internal Revenue Service.

Telecard retained control over the payment of wages, the fact that such checks were issued by Omniac does nothing to negate this. Omniac is not a viable business with its own independent functioning and independent employees. Omniac can not, did not, and does not undertake independent action. The payroll checks are paid only at the directive of Telecard, not upon Omniac's independent initiative. Finally, this Court notes that Kenneth Kumenzko, a CEO of Telecard, was the signatory on the Omniac account. Therefore, this Court finds that the Omniac account, from which employee payroll checks were issued, was clearly controlled by Telecard. This Court finds that Telecard is the statutory employer. Therefore, it was responsible for withholding and paying over its employee's payroll taxes. Accordingly, it is hereby

ORDERED AND ADJUDGED that the trustee's objection to Claim No. 25 is overruled.

DONE AND ORDERED in the Southern District of Florida on this 7th day of November, 2001.

RAYMOND B. RAY
United States Bankruptcy Judge